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MEMORANDUM OF LAW

DATE: November 20, 2000

TO: Leslie Burke, Council Representative, District 1

FROM: City Attorney

SUBJECT: Possible Conflict of Interest Related to Councilmember's Ownership of Stock in Verizon Communications

You asked the City Attorney's Office to determine whether Councilmember Mathis has a conflict of interest which would disqualify him from participating in or voting on an upcoming contract between the City of San Diego and Verizon Wireless.

QUESTION PRESENTED

In light of his ownership of stock in Verizon Communications, does Councilmember Mathis have a conflict of interest that would disqualify him from participating in the City Council's discussion and voting on a proposed contract between the City and Verizon Wireless for wireless telephone equipment and service?

SHORT ANSWER

Yes. Councilmember Mathis has a financial interest in Verizon, a business entity on which it is reasonably foreseeable there will be a financial effect as a result of the Council's decision on the wireless telephone contract between the City and Verizon. He is, therefore, disqualified from participating in that decision.

BACKGROUND FACTS

Verizon Wireless is a division of Verizon Communications, a wireless telecommunications company which is listed on the New York Stock Exchange, and is currently on the Fortune Magazine listing of the 1,000 largest United States companies, according to Kevin Glick from the National Accounts Division of Verizon. The total value of all of Verizon's outstanding shares of stock is approximately \$150.9 billion. Councilmember Mathis owns shares of stock in Verizon Wireless valued at over \$10,000, but less than \$100,000. Councilmember Mathis owns less than 3% of the total shares of Verizon stock, and does not receive dividends or other income from Verizon which exceeds 5% of his total annual income.

At the City Council meeting of November 20, 2000, the Council will be voting on a proposed contract between the City and Verizon Wireless. The proposed contract is a requirements contract for the provision of wireless telephone equipment and service to City departments. The agreement would entitle Verizon to be the exclusive provider of those services to the City for an initial period of two years, with three one year renewal options. The City Manager is recommending that Verizon be selected as the City's exclusive wireless telephone equipment and service provider, after a selection process in which four companies submitted proposals.

Because the contract with Verizon is a requirements contract, and the amount of service that Verizon will be provided under this agreement is unknown, it is impossible to precisely calculate the value of this contract to Verizon. However, based on an assumption that the City will experience a 20% growth in wireless telephone service over the five year period of the agreement, City staff analyzed the proposals and calculated the cost of the overall contract based on the four proposals. This calculation is contained in a Manager's Report, which is attached to this memorandum.

It was estimated by City staff that under Verizon's proposal, which was the lowest cost proposal, the cost of the Verizon contract to the City would be as follows: \$460,800 in the first year; \$547,200 in the second year; \$657,600 in the third year; \$771,000 in the fourth year; and \$927,600 in the fifth year; for a five year total of \$3,364,200.

ANALYSIS

I. Political Reform Act of 1974

This matter is governed by the Political Reform Act of 1974 [Act], which is codified at California Government Code sections 81000-91015. The Act was adopted to ensure that public officials perform their duties in an impartial manner, free from bias caused by their financial interests. Cal. Gov't Code § 81001.

A public official has a financial interest in a decision if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member or his or her immediate family, or on any of six economic interests delineated in California Government Code section 87103. Those six interests are investments in business entities; interests in real property, income received in the previous twelve months, positions in business entities, and gifts received in the previous twelve months. Investments, income and gifts must meet threshold dollar values set by the Act before they become potential sources of disqualification. Cal. Gov't Code § 87103.

The Councilmember is a public official within the meaning of the Act, and the Verizon contract matter on the November 20, 2000, Council docket is a governmental decision within the meaning of the Act. Cal. Code Regs., tit. 2, § 18701(a), 18702.1(a). Additionally, the Councilmember's ownership of stock in Verizon valued at \$10,000 or more is an economic interest for purposes of California Government Code section 87103, because it is an investment in a business entity.

To determine whether the decision on the Verizon wireless telephone service contract will have a material financial effect on the financial interest in question, the applicable materiality threshold must be identified. The threshold depends on the type of economic interest, and whether or not the interest is directly or indirectly involved in the governmental decision. It should be noted that the determination which must be made is whether the governmental decision has a material financial effect on the business entity that the official has an investment in, not the effect on the official's investment.

A business entity in which an official has a financial interest is considered to be directly involved in a governmental decision when the business entity initiated the proceeding, is named as a party in the proceeding, or is the subject of the proceeding. Cal. Code Regs., tit. 2, § 18704.1(a). A business is the subject of a proceeding when the decision involves a contract with the business. Cal. Code Regs., tit. 2, § 18704(a)(2). Therefore, Verizon is directly involved in the governmental decision in this case.

Because Verizon is directly involved in the Council's decision, the materiality standard that must be applied is that of title 2, section 18705.1(a) of the California Code of Regulations. According to that standard, if the official has an investment interest in a business which is listed on the New York Stock Exchange and the "Fortune 1000" list, and the official's investment is valued at \$10,000 or more, and the business is directly involved in the governmental decision, the effect of the decision on the business is deemed to be material, and the official is disqualified. Cal. Code Regs., tit. 2, § 18705.1(a).

Based on the foregoing, Councilmember Mathis is legally disqualified from participating in the wireless contract decision, and Councilmember Mathis should recuse himself from

participating in the discussions and voting related to that decision. Additionally, at the time the matter being heard by the Council, Councilmember Mathis must disclose on the record the economic interest which is the basis for this disqualification, and state that he is disqualifying himself from any participation in the decision. Cal. Code of Regs., title 2, § 18702.1(a)(5).

II. Government Code section 1090

California Government Code section 1090 [“Section 1090”] precludes a public officer or employee from participating in the making of a contract in which he or she is financially interested. Although the term “financial interest” is not specifically defined in the statute, an examination of the case law and the statutory exceptions to the basic prohibition indicates that the term is to be liberally construed. *Thomson v. Call*, 38 Cal. 3d. 633, 645 (1985).

A contract made in violation of section 1090 is void and cannot be enforced. Additionally, an official who violates section 1090 may be subject to criminal, civil and administrative penalties. Even when it has been determined that an official is disqualified from participating in a matter based on the Act, it is important to determine as a separate matter whether the official is disqualified from voting based on Government Code section 1090. In some cases, disqualification under section 1090 renders the entire decision making body disqualified from entering into the contract. *Thomson v. Call*, 38 Cal. 3d 633.

In the instant case, Councilmember Mathis would be “participating in the making of a contract” for purposes of section 1090 if he participates in the discussions or voting of the Council regarding the Verizon contract. However, because of the amount of stock that he owns, in relation to the value of all outstanding Verizon shares, and because of the amount of income that he derives from that stock ownership, his investment does not rise to the level of a financial interest for purposes of section 1090. Cal. Gov’t Code § 1091.5(a)(1). California Government Code section 1091.5(a)(1) provides that a public official shall not be deemed to be “interested” in a contract if the official owns less than 3% of the shares of a corporation, and if the total income to the official from dividends does not exceed 5% of his total annual income. Here, the amount of stock owned by Councilmember Mathis does not exceed 3% of the total value of Verizon’s outstanding stock of \$150.9 billion. Additionally, Councilmember Mathis is not receiving income from Verizon dividends which exceeds 5% of his total annual income.

Based on the foregoing, Councilmember Mathis is not disqualified from participating in the Verizon contract decision for purposes of California Government Code section 1090. However, because of the material financial effect of this contract on Verizon for purposes of the Act, as discussed in section I of this memorandum, Councilmember Mathis should recuse himself from participating in the decision.

CONCLUSION

Because the Council's decision on the wireless service contract will have a material financial effect on Verizon, Councilmember Mathis' stock ownership in Verizon is a disqualifying financial interest for purposes of the Act. For that reason, Councilmember Mathis should not participate in discussions or voting on this matter, and he should disclose the financial interest and the disqualification on the record at the time this matter is heard by the Council.

CASEY GWINN, City Attorney

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By

Lisa A. Foster

Deputy City Attorney

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